

Official Local Response to *The Commercial Appeal*

Questions on the Electrolux Project

The City of Memphis, Shelby County and the Greater Memphis Chamber appreciate the opportunity to review and comment on parts of *The Commercial Appeal*'s draft analysis of the Electrolux project. The materials provided appear to be part of a comparison of the costs and benefits of attracting the Electrolux facility to Memphis/Shelby County, though only materials related to the incentive and assistance programs involved (i.e., the "costs") were included. Because we have only seen a partial draft of the analysis, our comments required some interpretation of how *The Commercial Appeal* will use the data and, therefore, may not be complete. However, per your request we have tried to be as thorough as possible in assisting with this effort.

As outlined below, we have concerns with how the costs associated with the Electrolux incentive and assistance programs are being analyzed – specifically, the geographical context, the net present value calculation, and cost per job calculation.

Cost Per Job Calculation

The cost per job calculation seems skewed. The absence of any data on the benefits associated with the Electrolux project beyond the direct new jobs – (e.g., the tax impact of local spending by Electrolux and its new employees, the indirect new jobs that will be created as a result of that spending, new real and personal property taxes paid by Electrolux during the term of the PILOT agreement, and the jobs and capital investment associated with the suppliers Electrolux expects to locate at/near the plant) misrepresents the full value of the project..

As you know, the Memphis/Shelby County Industrial Development Board has a benefit/cost analysis done for each PILOT project. We believe that approach provides a sound – and likely conservative -- understanding of the Electrolux project. We would encourage you to review that analysis as part of your story. That analysis confirms that Electrolux will be a significant economic generator for the Memphis/Shelby County economy and has a positive benefit cost ratio.

Geographical Context

The Commercial Appeal analysis includes all the city, county and state incentive and assistance programs. We have the sense that the intent is to compare the cost of all those programs to the local (Shelby County) benefits derived from the Electrolux project. We strongly believe that to be relevant, benefits and costs need to be compared on a comparable geographic footprint –(e.g. if your interest includes all the state/local incentive and assistance programs, they need to be compared to statewide benefits.). The level of complexity for the analysis to consider all state as well as local benefits is considerable and likely beyond the purview of this article. However, a comparison of local costs and local benefits is readily

discernable and most relevant. From our perspective, the decision to compete for and win the Electrolux project was based solely on the benefits and costs for Memphis/Shelby County.

We are grateful to the state for their aggressive role in helping bring Electrolux to Memphis/Shelby County. Their investment, similar to their investment in other major projects such as the new Volkswagen facility in Chattanooga and Wacker Chemie near Cleveland was instrumental in making the project a reality. However, just as local officials in those communities made their decisions based on local impact, so did Memphis/Shelby County.

Net Present Value Calculations

The Commercial Appeal has calculated the net present value of various dollar streams over time (e.g. state and local debt service payments or property taxes paid and abated). While we understand the process, we have significant questions about the methodology utilized. Specifically, we see no evidence that other factors that impact those cash-flows over time were accounted for, such as: property value increases/decreases, the timing of construction disbursements or property tax bills, or local property tax rate changes. Similar concerns would impact the flow of revenues or project “benefits” over time, if that were part of the analysis. In addition, we have concerns over the selection of an appropriate discount rate.

We fully understand the difficulty in selecting an appropriate discount rate. We also know how that choice can have significant influence on the outcome. Absent any compelling and explicit rationale to the contrary, we believe that when there is a known (or assumed) cost of funds – as you have here -- the discount rate should mirror that known cost. To do otherwise, as *The Commercial Appeal's* analysis does, leads to bizarre conclusions. For example:

In your materials on the City/County debt issue, the City and County’s time value of money, as reflected in the discount rate, is less than the interest rate they are forced to pay on their debt. The result is, on the day the \$44 million City/County debt issue closes, *The Commercial Appeal* calculates that debt has a net present value of \$54 million. We believe that when the markets are behaving normally, the accurate discount rate for a debt repayment stream over time is the interest rate paid, and the corresponding net present value is the face value of the debt issue. [Note: the materials you provided seem to show the City/County debt with a \$44 million “sticker amount,” a 2.99% interest rate, and \$3.1 million annual debt service. Neither the face amount nor the interest rate match current assumptions, nor can we replicate the annual debt service amount given the assumptions made.]

Cost Per Job

Impact of discount rate: this is another example where the choice of discount rate *The Commercial Appeal* analysis uses affects the outcome. Your documents show the total cost of state/county/city incentives to be \$195.6 million, but the net present value is said to be \$221.0 million. We do not agree with that approach.

Statewide vs. local impact: Our sole concern is local benefit as compared to local costs. As such, while the state assistance made the Electrolux project possible, it was not part of our calculation.

Indirect jobs: *The Commercial Appeal* analysis does not take into account indirect jobs. In our analysis, there are 1,240 direct jobs at Electrolux and 1,636 indirect jobs created throughout Shelby County, for a total of 2,876 jobs. These indirect jobs are based on historic input/output analyses of the Shelby County economy and reflect spending by Electrolux and its direct employees. These indirect jobs do not include any of the up to 2,260 Electrolux supplier jobs the company expects to locate either on site or in proximity to the new plant (which, coupled with the projected \$500 million of additional capital investment, would then create another 2,800+ indirect jobs).

One time v. 15 year value: *The Commercial Appeal* analysis compares costs incurred over a 15-year period against the number of jobs in a single year. A better approach would be to compare annual costs with the annual number of jobs.

Recalculation: Based on the comments above, we estimate the annual cost of local incentives/assistance per job is \$2,331, calculated as:

$\$100,546,923 \text{ local cost over 15-years [Younger \& Associates analysis for the Memphis/Shelby Co. IDB]} / 2,876 \text{ total new Shelby County jobs at full operation} = \$34,961 / 15 \text{ years} = \$2,331/\text{job/year}.$

Context: To put the cost per job analysis into perspective, the U.S. Small Business Administration has valued a typical job at a small-to-medium size firm at \$162,500 on a one time (not annual) basis and for small manufacturers, \$250,000 per job on a one time basis.

Conclusion

In conclusion, while we understand there are numerous approaches for analyzing the benefits and costs associated with a project like Electrolux, we believe based on the methodology we employed that Electrolux is an outstanding project that will make sizeable contributions to Memphis and Shelby County. That conclusion is supported by an independent analysis by Younger & Associates, prepared for the Memphis/Shelby County Industrial Development Board, which showed that local benefits outweigh local costs, without any assumption about additional jobs and investment by the anticipated suppliers locating on-site/proximate to the plant. Some of the key assumptions incorporated into that analysis were:

That benefit/cost analysis was prepared from a Shelby County perspective; only those costs that accrue to Shelby County were considered and only those jobs that will be created inside Shelby County were considered. This is the appropriate framework for making decisions about Shelby County investments.

The Shelby County analysis was conducted in constant dollars rather than using a net present value scenario. In a constant dollar analysis all dollar values are kept at current (in the case of Electrolux 2010) dollars. This eliminates the need to guess interest rates, inflation rates, tax rates, timing of cash flows and wage fluctuations. The fewer assumptions that have to be made, the fewer opportunities there are to introduce error into the analysis.

Constant dollar analyses are appropriate in situations where the inflows and outflows of money occur over a similar time period. In the case of Electrolux the major benefits come from jobs over the life of the project and the major Shelby County outflows are annual bond payments over 20 years. This differs, for example, from transportation projects where net present values are often used. In those situations the outflow occurs in the planning and construction phases which are all paid up front without bonds, and the all the benefits come later over the long life of the infrastructure.

The benefit/cost analysis was designed to be conservative in projecting benefits. Since it is a tool for decision making, it is important not to overstate potential revenues. An overstatement of revenues could lead to future financial shortfalls while an understatement could potentially lead to surpluses, which from a fiscal point of view could be seen as minimizing risk. There are always some unknowns before a project is underway, so designing an analysis that is conservative in revenue projections helps to mitigate unforeseen cost or revenue issues.

An example of this conservative approach can be seen in the projection of indirect jobs from the Electrolux project. Electrolux is preparing a campus in Memphis where their primary suppliers will locate. Electrolux, at the time of their application for incentives, projected that the suppliers locating at/near the plant would create 2,260 jobs. The benefit/cost analysis did not include those suppliers; the RIMS II multiplier was applied only to the 1,240 direct new Electrolux jobs, which then projected 1,636 indirect jobs in Shelby County.

The multiplier used was the U.S. Bureau of Economic Analysis multiplier specific to Shelby County for electronic and appliance manufacturing. Like all USBEA multipliers it is calculated based upon past performance of the county economy – in this case how many jobs have to be created in the county economy to support the level of activity at Electrolux. Since there has not been this level of activity in that economic sector in Shelby County prior to the project, the multiplier is most likely low in predicting the number of indirect jobs needed. It is more accurate in projecting the indirect jobs that will be created in the early years of the project, but as the company and its suppliers become more established over time the number of indirect jobs will grow. Not all manufacturers require their suppliers to be onsite, so with other projects a larger portion of the supplier jobs are created in other counties.

Another example of the conservative nature of the analysis concerns local funds spent on public infrastructure at the Pidgeon Industrial Park. Those investments will help attract additional companies to locate in the Park, thus providing a tangible future benefit beyond the Electrolux project. However, none of that future benefit is included in the analysis.

The benefit cost ratio was found to be 1.06:1 when analyzing the data from the Electrolux application and the known costs to Memphis/Shelby County. This means that over a 20 year period, Memphis and Shelby County will receive more money in tax revenues than the cost of both the cash outlay for infrastructure and the opportunity (non-cash) cost of forgoing a portion of potential property tax from the project.

Further, as noted above, a large portion of the local “cost” of the Electrolux project, are the taxes abated under the PILOT. While this is appropriate based on the methodology utilized, we also recognized that to a large extent those costs are fictional. The abated taxes are monies the City/County have never received and were never likely to receive, given that virtually all sizable industrial projects in Shelby County (and

DeSoto County, for that matter) over the past 10+ years have required real and personal property tax abatements. As a result, the probability of an alternative use for the Pidgeon Industrial Park site being occupied by Electrolux where the project would pay full City/County taxes is extremely low, making the "opportunity cost" of granting Electrolux a PILOT incentive virtually zero. Conversely, the \$22.5 million of new property taxes paid over 20-years by Electrolux are very "real."

Each direct job created by Electrolux will generate \$3,310 in tax revenue for Memphis and Shelby County over 15-years. This benefit is in addition to the benefits generated by the construction and set up of the facilities, and the outside public dollars attracted from the State and Delta Regional Authority to build infrastructure in Shelby County.

We look forward to discussing a more complete picture of the Electrolux project with *The Commercial Appeal*.